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Jeb Hensarling: Dodd-Frank's Unhappy Anniversary

Two years after Washington 'reformed' Wall Street, the economy stinks and 'too big to fail' is enshrined into law.

By JEB HENSARLING

Two years ago, I was one of 43 members of Congress appointed to the conference committee for the Dodd-Frank financial-reform bill. Along with others, I fought against the legislation and lost.

After an all-night session, Democrats (who then held the House majority) produced a 2,300-page behemoth they touted as a panacea for financial crises. President Obama predicted the bill would "lift our economy," give "certainty to everybody" and end "tax-funded bailouts—period" because it would no longer allow institutions to become "too big to fail."

Two years later, we remain mired in the worst economy in the postwar era, "too big to fail" is actually enshrined into law, and Dodd-Frank's voluminous rules are proving to be some of the most confusing, complex and harmful our capital markets have ever seen.

Dodd-Frank was based largely on the premise that regulators lacked the authority to prevent Wall Street from taking outsize risks. But that was the wrong diagnosis—and it led, inevitably, to a prescription for the wrong remedy.

Before the crisis, regulatory mistakes and incompetence abounded—but almost no examples of a lack of regulatory authority can be found. Federal regulations were not the solution to the crisis but its principal cause. Federal policy pushed financial institutions to lend money to people for home purchases they couldn't afford. This dramatically eroded historically prudent underwriting standards. Of the subprime and Alt-A mortgages that led to the 2008 financial crisis, more than 70% were backed by the federal government through government- sponsored enterprises (GSEs, such as Fannie Mae and Freddie Mac), the Federal Housing Administration and other programs. An accommodative monetary policy, in turn, allowed an inflated housing bubble that finally burst.

Having incorrectly diagnosed the problem, Dodd-Frank's authors wrote 400 new regulations. These generally fall into one of two categories: those that create uncertainty and those that create economic harm.

A prime example is the so-called Volcker rule. This 300-page proposal (to limit the kinds of investments banks can make) is not yet finalized by regulators. The proposal includes roughly 1,300 questions covering nearly 400 topics—and is so confusing that it elicited more than 18,000 comment letters from market participants and the public.

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Another example is the rules contained in Dodd-Frank's derivatives title, which the U.S. Chamber of Commerce says could make it more expensive for nonfinancial companies to hedge their risks, possibly causing "hundreds of American companies to take their capital and jobs elsewhere." Then there is the "Qualified Residential Mortgage" rule that, if implemented by regulators as they have proposed, will increase mortgage interest rates by one to four percentage points, according to Moody's Analytics. And these are just a few of the law's 400 rules.

The House Financial Services Committee estimates that private-sector job creators will have to spend 24,180,856 hours each year to comply with Dodd-Frank—and that's only for the 224 rules that have been written to date. William Isaac, a former chairman of the Federal Deposit Insurance Corporation, has predicted that hundreds if not thousands of community financial institutions will ultimately buckle under the regulatory load. As one community banker in my native Texas remarked, "My major risks are not credit risks, risks of theft, risks of some robber coming in with a gun in my office; my number one risk is federal regulatory risk."

Dodd-Frank harms not only businesses but consumers, too, by creating the benignly named "Consumer Financial Protection Bureau." This bureau gives unparalleled power to an appointed credit czar who can ban or ration practically any consumer financial product deemed "unfair" or "abusive"—based on his or her discretion alone, with virtually no oversight from Congress.

Rationing consumer credit will make it more expensive for entrepreneurs to obtain capital and will stifle both product innovation and consumer choice. Had the new bureau existed 50 years ago, today we might be without ATMs, frequent-flier miles or debit cards.

Perhaps most harmful, Dodd-Frank has codified into law a taxpayer-funded safety net for institutions deemed too big to fail—the Orderly Liquidation Authority, which the Congressional Budget Office predicts will cost taxpayers tens of billions of dollars. In downgrading the credit ratings of the nation's largest banks last month, Moody's explicitly stated that its ratings still reflect an assumption "about the very high likelihood of support from the U.S. government for bondholders or other creditors in the event that such support is required to prevent default." So much for ending taxpayer-funded bailouts. And when we lose our ability to fail, we will soon lose our ability to succeed.

Consider also what Dodd-Frank fails to do. Instead of eliminating government-sponsored enterprises—which have received $200 billion and counting in taxpayer-funded bailouts since 2008 and were at the epicenter of the crisis—Dodd-Frank leaves them in a state of perpetual federal conservatorship. Through Fannie Mae, Freddie Mac and the Federal Housing Administration, taxpayers now back 99% of new residential mortgage securitizations.

So where do we go from here? For starters, the president should work with Congress to phase out the government-sponsored enterprises and transition them to the private market. Other industrialized nations enjoy comparable or higher rates of homeownership without government dominance in their mortgage markets. Next, Dodd-Frank's bailout authority must be repealed. The way to address the risks posed by financial institutions would be more transparent balance sheets and a meaningful application of capital and liquidity standards. As long as companies have enough capital to cover their risks and absorb potential losses, we don't need federal regulators micromanaging credit allocation.

If Washington regulators were competent enough to manage risk, the government-sponsored enterprises wouldn't have been forced to guarantee subprime mortgages and wouldn't have needed a taxpayer-funded bailout, and the National Flood Insurance Program and the Pension Benefit Guarantee Corporation wouldn't be in the red. If Washington bureaucrats could be trusted with credit allocation, Solyndra would never have received a dime from taxpayers.

If Americans want the jobs and economic growth that flow from innovative, competitive and transparent capital markets, we should commit to making this anniversary Dodd-Frank's last.

Mr. Hensarling is a Republican congressman from Texas.

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